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No. 504

In the Supreme Court of the United States

OCTOBER TERM, 1961

SCRIPTURE PRESS FOUNDATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE RESPONDENT IN OPPOSITION

ARCHIBALD COX,
Solicitor General,
LOUIS F. OBERDORFER,
Assistant Attorney General,
JOHN B. JONES, Jr.,
HARRY BAUM,
HAROLD M. SEIDEL,
Attorneys,
Department of Justice,
Washington 25, D.C.

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OPINION BELOW

The opinion (Pet. 1a–13a) of the Court of Claims is reported at 285 F. 2d 800. The court's findings of fact are reprinted at Pet. 14a–61a.

JURISDICTION

The Court of Claims' amended judgment dismissing the taxpayer's petition, insofar as it claimed exemption under Section 101(6) of the Internal Revenue Code of 1939, was entered July 19, 1961 (Pet. 13a, 61a–62a). The petition for a writ of certiorari was filed on October 17, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether the record warrants the finding of the court below that the petitioner corporation was operated for the primary purpose of carrying on a business for profit (publishing and selling religious educational materials), and therefore did not qualify for income tax exemption under Section 101(6) of the Internal Revenue Code of 1939 as a corporation "organized and operated exclusively for religious * * * or educational purposes".

STATUTES AND REGULATIONS INVOLVED

Sections 101, 421, and 422 of the Revenue Code of 1939 and Section 39.101(6)–1 of Treasury Regulations 118 are set forth in part in the Appendix, *infra*, pp. 17–21.

STATEMENT

In 1932, Mr. and Mrs. Victory Cory organized Scripture Press, Inc., a profit corporation under Illinois law, to publish and sell the All Bible Graded Series of Sunday School Lessons conceived and composed by Dr. Clarence H. Benson. The Corys, who have been the dominant personalities behind both Scripture Press, Inc. and the taxpayer, Scripture Press Foundation, are deeply religious people. They are adherents of the evangelical theory of the Protestant faith, and believe that they have a Christian mission to provide and disseminate improved Sunday school teaching and lesson materials and thereby advance and improve Christian education. (Pet. 1a, 4a, 36a, 37a, 42a–44a, 46a, 47a.)

The All Bible Lessons are lesson materials prepared in series according to age groupings of children

attending Sunday school. The lessons are dated for each Sunday in the calendar quarter for which the series is published. These lessons provide a high quality curriculum for Sunday schools which permits effective instruction, despite their lack of training, by lay teachers. (Pet. 36a, 59a.)

From an inconspicuous beginning, the sales of Scripture Press, Inc. steadily grew in volume and in profit. By May, 1945, its original capital of $2,500 had increased to $30,710 of capital and surplus. In addition to selling the Bible lessons, the corporation operated a book store in downtown Chicago. It also provided some instruction for Sunday school teachers and representatives and made some cash and merchandise grants to various religious organizations. (Pet. 36a, 37a, 38a, 40a, 46a.)

After having discussed the tax consequences of a tax exempt status with the accountant for Scripture Press, Inc., the Corys had the taxpayer, Scripture Press Foundation, organized under the Illinois "General Not for Profit Corporation Act" as a non-stock, non-profit corporation. The Corys, who owned all but one share of the corporation's stock, and Harry G. Saulnier, Mrs. Cory's brother-in-law, who owned the other share, donated their stock to the taxpayer-Foundation, and Scripture Press, Inc. was then liquidated into the taxpayer. (Pet. 14a, 21a, 38a, 48a.)

The taxpayer's original articles of incorporation stated that its purposes were the dissemination and distribution of the Gospel, the Scriptures, devotional literature, and of "helps and supplies for use in Christian activities", as well as the organization and

support of organizations, institutions, and movements exclusively devoted to Christian missionary educational and other evangelical efforts. To effect these purposes, the incorporating articles authorized the taxpayer to engage in—

> 1. The production, purchase, circulation, distribution, and sale of Christian literature, including books, periodicals, pamphlets, tracts, placards, mottos, and supplies; and
> 2. The conduct of publication and printing establishments.

The by-laws barred diversion of funds to any corporate member, director, or officer, other than for compensation for services. (Pet. 15a, 16a.)

The transfer of the business from the corporation to the taxpayer-foundation involved no changes in the mode of operations or in its policies except that the business enjoyed a rapid growth thereafter. The taxpayer has continued to publish the Bible lessons as well as other religious literature, and it has continued to provide instruction in Sunday school teaching. The taxpayer also purchases and sells items useful in the operation of a Sunday school; these sales comprise about 15 percent of its total business. In 1956, taxpayer completed construction of a new building at a total cost in excess of $1,000,000; of the total cost taxpayer expended $488,000 from its surplus and borrowed the remainder. In addition to carrying on all of its editorial, publishing, and sales operations in the building (except the Chicago bookstore), the taxpayer also operates a store there. In 1957, taxpayer employed about 240 persons, six of whom devoted their full

time to religious education instruction and sixteen of whom devoted only part of their time to that work. (Pet. 48a, 50a–58a.)

The taxpayer is not an institution of any church and has no affiliation, direct or indirect, with any religious denomination or church. Taxpayer's sales steadily increased from $1,170,444 for fiscal year ended January 31, 1951, to $2,529,953.42 for fiscal 1957. Taxpayer's capital upon organization in 1945, amounted to $30,710.11. By the end of fiscal 1957, capital and accumulated surplus amounted to $1,610,817 all of which represented earnings (except for the $30,710.11, the net worth of Scripture Press, Inc., on dissolution).

The taxpayer's annual expenditures for religious educational programs, its net profit *after* deduction of all expenses, including the aforementioned instructional expenses, and the balance of accumulated earnings is shown by the following table (Pet. 8a, 56a, Table II):

	1 Expenditures for religious educational programs	2 Net income after all deductions, including amounts in column 1	3 Accumulated retained surplus
1951	$21,847.67	$119,078.87	$476,311.14
1952	29,434.88	108,149.70	585,010.10
1953	30,472.08	159,782.16	744,798.26
1954	41,454.42	278,151.83	982,380.70
1955	46,378.93	217,250.77	1,188,629.17
1956	48,041.44	280,403.97	1,408,992.42
1957	72,886.27	141,924.88	1,610,817.30

In 1946, the taxpayer applied for and received a ruling from the Commissioner of Internal Revenue that it was exempt from income tax under Section 101 (6) of the 1939 Internal Revenue Code because it was

organized and operated exclusively for religious purposes. In March, 1953, the Supreme Court of Illinois held in *Scripture Press Foundation* v. *Annunzio,* 414 Ill. 339, that the taxpayer was not exempt under the Illinois Unemployment Compensation Act, which repeats in *haec verba* the operative language of 1939 Code Section 101(6). In October, 1953, the Commissioner of Internal Revenue requested certain information from the taxpayer in view of changes in revenue legislation subsequent to the issuance of the taxpayer's exemption ruling. After receiving the information and on December 31, 1953, the Commissioner revoked taxpayer's exemption for its fiscal year ended January 31, 1953, and for all subsequent years. (Pet. 28a–32a.)

Near the end of January, 1954, the taxpayer amended its articles of incorporation to eliminate the organizational purpose of operating a printing establishment and by including a paraphrase of the language of 1939 Code previously stated Section 101(6). The purposes previously stated were elaborated upon, and a provision was included to the effect that on dissolution, the assets were to be conveyed to a religious, charitable, scientific, literary or educational organization or organizations. Taxpayer protested the revocation of its exemption and on December 31, 1954, the protest was denied. (Pet. 18a–19a, 32a–35a.)

The taxpayer paid a tax in 1955 for fiscal years ended January 31, 1953, and 1954, on the income from its bookstores on the ground that the stores were an unrelated trade or business under Supplement U (Section 421, *et seq.*) of the 1939 Code

(which levies an income tax on such income of exempt organizations) and brought suit below for refund of the amounts paid on March 6, 1956. In March, 1957, the Commissioner proposed the assessment of deficiencies for both 1953 and 1954 with respect to the rest of taxpayer's income on the ground that taxpayer was not an exempt organization; he also proposed increases in the amount of its income as a result of certain adjustments. Taxpayer paid the additional amount claimed as due by the Commissioner for 1953 and amended its original petition to include this later payment, electing to remove the 1954 year from the Court of Claims' jurisdiction by filing a petition respecting it in the Tax Court (Pet. 14a, 35a.)

The Court of Claims found that a substantial, and the predominant, part of taxpayer's activities consisted of engaging in business for profit, *i.e.*, publishing and selling Bible lessons and other religious educational materials, and accordingly held that petitioner did not qualify for exemption from income tax under Section 101(6) of the Internal Revenue Code of 1939. (Pet. 1a–13a.)

ARGUMENT

The Court of Claims here found on the facts presented that the dominant purpose of petitioner was to engage in the commercial activity of selling religious literature. Under the statute, the Regulations, and the decisions of this and other courts, this finding, which is clearly supported by the evidence, precludes exemption from tax. There is no conflict of decisions or other occasion for review by this Court.

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1. To qualify for income tax exemption under Section 101(6) of the Internal Revenue Code of 1939, Appendix, *infra*, p. 17,[1] a corporation must satisfy several specified conditions, the chief one of which is that it be "organized and operated exclusively for religious * * * or educational purposes." The applicable Treasury Regulations provide that "an organization organized or operated for the primary purpose of carrying on a trade or business for profit is not exempt" under Section 101(6).[2] Section 39.101(6)-1(a)(1) and 1(d) of Treasury Regulations 118, Appendix, *infra*, p. 20.

As is plain from its opinion, the court below applied the test prescribed in the statute and in the Regulations. Addressing itself to the issue whether the taxpayer's publishing and selling activities were merely incidental to its religious or educational activities, or reflected the primary purpose of its organization and operations, the court concluded that (Pet. 10a–11a) petitioner's "primary" and "dominant" purpose was to carry on a business of selling religious educational literature for profit. Its conclusion is amply supported by the undisputed facts—the nature and extent of petitioner's business activities: the disparity between the large amounts of sales

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[1] 1954 Code Section 501(c)(3) is substantially the same, but is not applicable to the taxable year here involved (fiscal year ended January 31, 1953). See 1954 Code Section 7851(a)(1)(A).

[2] The "profit" proscribed means simply an excess of receipts over costs, since the inurement of such profits to a private individual would automatically disqualify the organization under the statute and Section 39.101(6)-1(a)(2) of the same regulation.

profits realized annually from 1951 to 1957 and the amounts expended for religious or educational purposes, resulting in a steadily increasing accumulated earned surplus; and the relatively small number of employees engaged in religious and educational work as compared with those engaged in business activities.[3] The Illinois Supreme Court reached the same conclusion as to this corporation in an earlier case under the Illinois Unemployment Compensation Act which repeats the language of 1939 Code Section 101(6). *Scripture Press Foundation* v. *Annunzio*, 414 Ill. 339.

2. The decision below is not, as petitioner implies (Pet. 13–14, 19), in conflict with *Trinidad* v. *Sagrada Orden*, 263 U.S. 578. In that case an exempt religious organization undertook as a minor part of its activities to sell wine and chocolate to its member churches, from which activities it received a trivial amount of income. The government contended that these activities deprived the organization of its tax exempt status, because it was not "operated exclusively" for religious purposes. In holding that the

[3] The Court contrasted the substantial amount of petitioner's accumulated earnings from publishing and selling bible lessons and other literature, and operating a book store, with the amount spent for religious or educational purposes. As appears from the court's findings and tabulations (Pet. 8a, 40a), between 1950 and 1957 petitioner accumulated earnings totaling $1,580,107.19, while during the same period it spent a total of $296,483 on religious education, thus retaining about 80 per cent of its sales profits. Moreover, out of 240 employees only six devoted full time and 16 part time to religious education, over 90 per cent being engaged full time in the business of publishing and selling. (Pet. 48a.)

organization did not lose its exemption, the Court (p. 581) used the language quoted by petitioner (Pet. 14) suggesting that the exemption depended not upon the "source of the income", but rather upon its "destination." However, the Court immediately thereafter noted (p. 581) that such "limited trading, if it can be called such, is purely incidental to the pursuit of those [religious] purposes, and is in no sense a distinct or external venture."[4]

The plain implication of the Court's decision in *Sagrada Orden* (p. 582) is that a corporation whose activities "amount to engaging in trade", such as "selling to the public or in competition with others", is not within the exempt class even though it also performs tax exempt activities. In short, the very reasons which impelled this Court in *Sagrada Orden* to hold that the organization there involved was exempt compels the opposite conclusion here. See *United States* v. *Community Services,* 189 F. 2d 421 (C.A. 4th), certiorari denied, 342 U.S. 932; Sec-

[4] The crux of its opinion is to be found in the following language (p. 582):

"As respects the transactions in wine, chocolate and other articles, we think they do not amount to engaging in trade in any proper sense of the term. It is not claimed that there is any selling to the public or in competition with others. The articles are merely bought and supplied for use within the plaintiff's own organization and agencies—some of them for strictly religious use and the others for uses which are purely incidental to the work which the plaintiff is carrying on. That the transactions yield some profit is in the circumstances a negligible factor. Financial gain is not the end to which they are directed."

tion 39.101(6)-1(d) of Treasury Regulations 118, Appendix, *infra*, p. 20.

In *Better Business Bureau* v. *United States*, 326 U.S. 279, relied on by petitioner as confirming the "destination" test (Pet. 15), this Court decided that the ultimate purposes were not exclusively educational, and had no occasion to consider the effect of a severable commercial activity on the ultimate purpose.

3. Nor is the decision below in conflict with *Commissioner* v. *Orton*, 173 F. 2d 483 (C.A. 6th), the principal appellate decision upon which petitioner relies. (Pet. 15.) The court there declined to disturb the Tax Court's findings that the "predominate purpose" for which the taxpayer foundation was organized and operated was to promote the science or art of ceramics, and that the earnings derived from the sales of ceramics were used to further research in the field of ceramics. Here, on the other hand, the Court of Claims found that petitioner's primary and dominant purpose was to engage in the business of publishing and selling religious educational materials for profit, and that only a fraction of its profits was used for religious or educational purposes.

The difference in the underlying facts makes clear the reasons for allowing exemption in *Orton*. The founder there took great care that all commercial activity should be subordinate to the scientific purpose.[5] An accumulation of profits was prevented by

[5] For example, the manufacturing business was to be terminated "if scientific progress makes it no longer necessary or

a specified pricing formula that held profits down and directed that a substantial percentage of gross revenues (all of the profits) be spent on research and experimentation. Neither the express subordination of commercial activity nor the immediate devotion of excess revenues to the exempt purpose is present in this case.[6]

Sico Co. v. *United States,* 102 F. Supp. 197, upon which petitioner also relies (Pet. 15), was decided by the Court of Claims, the same court which decided the instant case, and is to be contrasted with the recent contrary decision of the same court in *Sico Foundation* v. *United States,* 61–2 C.C.H., par. 9732 (C. Cls., November 1, 1961). These two cases involved a "feeder corporation"—a corporation which engages in business activity itself but is committed to pay over all its income to charity. Prior to 1950 some feeder corporations were found exempt, as was Sico, but Congress expressly made them taxable under a new paragraph added to Section 101(6) of the Code by Section 301(b) of the Revenue Act of 1950,

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desirable to continue" and the assets were to be paid over to Ohio State University. 173 F. 2d, at p. 485.

[6] To the contrary petitioner has stated (Pet. 30a):

"We do not make any distributions of profits as such. We endeavor to maintain a sound financial condition. We find ourselves compelled to shortly give up inadequate rented quarters in Chicago; and we are seeking to procure finances for a suitable headquarters building outside the City. We have started a reserve toward its cost.

"We treat as a part of our current expense the amounts which we expend directly for religious purposes without requiring or seeking any direct return. These are shown on Schedule 5. In addition, we serve churches generally on as near a sound cost basis as we think we conservatively can."

disclaiming any intent to affect decisions under prior law. See H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 36–37, 41–42, 124 (1950–2 Cum. Bull. 380, 409, 412 469); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 28–29, 35, 116 (1950–2 Cum. Bull. 483, 504, 509, 565–566). Some courts found feeders taxable for prior years without benefit of legislation. See, *e.g.*, *United States* v. *Community Services, supra.*

A court which had found a feeder corporation exempt under the destination test before these amendments would presumably find the petitioner—a self-feeder—exempt if it continued to follow the same rule for later years. However, the Court of Claims in this case, and in the second *Sico* case, has interpreted the 1950 amendments[7] as reflecting a Congressional rejection of the ultimate destination of the funds as the sole criterion of exemption after 1950. No court of appeals which followed the destination test has decided that it will persist under present law. Thus there is no conflict of decisions at this time.

4. Petitioner attempts at some length to associate its tax status with that of tax-exempt denominational publishing houses—publishers owned and operated by established churches. (Pet. 19–21.) It is suggested that the decision of the Court of Claims in this case will cut off their exemptions as well.

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[7] Section 301(a) of the Revenue Act of 1950 also added a tax on unrelated business income, Supplement U to the 1939 Code (Section 421, *et seq.*). Since the Court of Claims held the petitioner not to be exempt, it did not decide the extent to which the business profits of petitioner should be taxed under these sections.

We suggest, however, that an organization subject to direct church control places less emphasis on profitable operation and when profits arise devotes them immediately to exempt purposes. The profit-making thus tends to be subordinated to the larger purposes of the church. If in a specific case a denominational publishing house escaped these normal controls and concentrated its energies on commercial activity to the same extent as petitioner here, it, too, would lose its exemption under the Regulations as applied by the Court of Claims below. Petitioner is not discriminated against merely because no competitor has hitherto been found to have placed its primary emphasis on commercial activity. The same rules are applicable to both.

5. Even if this Court were disposed to consider a case on the current vitality of the destination test, this case is not a satisfactory one for resolution of the point as this corporation's earnings during the year in question may not have been irrevocably committed for religious or educational purposes. The Supreme Court of Illinois in 1953 held as to this same corporation (*Scripture Press Foundation* v. *Annunzio, supra*, 414 Ill. at pp. 357–358):

> Under the provisions of sections 45(d) and 45(e) of the general Not-for-Profit Corporation Act of Illinois the members and officers of Scripture Press Foundation, upon its dissolution, would determine, in their discretion, the manner in which its assets would be distributed, without limitation.

While the Court of Claims did not rest its decision below on this ground, and while there may be room for argument over the implications of the Illinois Supreme Court's opinion, it would present obvious difficulties for this Court to have to resolve that question of local law in order to reach the federal question. Petitioner amended its articles of incorporation in 1954 to impose the prescribed limitation on distribution of assets (Pet. 12a), but it may be doubted that this amendment would retroactively make the organization exempt for 1953, the only year in question here. At the very least it can be said that it is unclear that petitioner's earnings for 1953 were irrevocably committed to religious or educational purposes during the year for which exemption is sought. In such circumstances, review of this case might not result in clarification of the destination test.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
JOHN B. JONES, JR.,
HARRY BAUM,
HAROLD M. SEIDEL,
Attorneys.

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APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

Except as provided in paragraph 12(B) and in supplement U, the following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. For loss of exemption under certain circumstances, see sections 3813 and 3814;

* * * * *

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph, the term "trade or business" shall not include the rental by an organization of its real property (including

personal property leased with the real property).[8]

* * * * *

Supplement U—Taxation of Business Income of Certain Section 101 Organizations[9]

SEC. 421. IMPOSITION OF TAX.

(a) *In General.*—There shall be levied, collected, and paid for each taxable year beginning after December 31, 1950—

(1) upon the supplement U net income (as defined in subsection (c)) of every organization described in subsection (b)(1), a normal tax of 25 per centum of the supplement U net income, and a surtax of 20 per centum of the amount of the supplement U net income in excess of $25,000.

* * * * *

(b) *Organizations Subject to Tax.*—

(1) *Organizations taxable as corporations.*—The taxes imposed by subsection (a)(1) shall apply in the case of any organization (other than a church, a convention or association of churches, or a trust described in paragraph (2)) which is exempt, except as provided in this supplement, from taxation under this chap-

[8] The last-quoted paragraph of Section 101, added by Section 301(b) of the Revenue Act of 1950, 64 Stat. 906, 953. Section 303 of that Act provided:

"SEC. 303. EFFECTIVE DATE OF PART I.

"The amendments made by this part shall be applicable only with respect to taxable years beginning after December 31, 1950. The determination as to whether an organization is exempt under section 101 of the Internal Revenue Code from taxation for any taxable year beginning before January 1, 1951, shall be made as if section 301(b) of this Act had not been enacted and without inferences drawn from the fact that the amendment made by such section is not expressly made applicable with respect to taxable years beginning before January 1, 1951."

[9] Supplement U was added by Section 301(a) of the Revenue Act of 1950, 64 Stat. 906, 947.

ter by reason of paragraph (1), (6), or (7) of section 101. * * *

* * * * *

(c) *Definition of supplement U net income.*—The term "supplement U net income" of an organization means the amount by which its unrelated business net income (as defined in section 422) exceeds $1,000.

* * * * *

SEC. 422. UNRELATED BUSINESS NET INCOME.

(a) *Definition.*—The term "unrelated business net income" means the gross income derived by any organization from any unrelated trade or business (as defined in subsection (b)) regularly carried on by it less the deductions allowed by section 23 which are directly connected with the carrying on of such trade or business, subject to the following exceptions, additions, and limitations: * * *

* * * * *

(b) *Unrelated Trade or Business.*—The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 421(a), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101, except that such term shall not include any trade or business—

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) which is carried on, in the case of an organization described in section 101(6), by the organization primarily for the convenience of its members, students, patients, officers, or employees; or

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

* * * * *

2. Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

SEC. 39.101(6)-1 RELIGIOUS, CHARITABLE, SCIENTIFIC, LITERARY, AND EDUCATIONAL ORGANIZATIONS AND COMMUNITY CHESTS.

(a) In order to be exempt under section 101(6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

* * * * *

(d) Since an organization exempt under section 101(6) must be organized and operated exclusively for one or more of the specified purposes, an organization organized or operated for the primary purpose of carrying on a trade or business for profit is not exempt thereunder. Thus, such an organization is not exempt under section 101(6) even though it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization. See section 101(18) as to religious or apostolic associations or corporations. Organizations, including trusts, otherwise exempt from tax under this section (other than a church, or a convention or association of churches) are taxable on Supplement U net income. See sections 421 to 424, inclusive, and the regulations thereunder.

(e) A corporation otherwise exempt under section 101(6) does not lose its status as an exempt corporation by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

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